Supreme Court, U.S.
FILED
MAY 27 1993
OFFICE OF THE CLERK

No. 92-1726

In The

Supreme Court of the United States

October Term, 1992

ENRON OIL & GAS COMPANY,

Petitioner,

v.

BRUCE BABBITT, Secretary of the Interior, UNITED STATES DEPARTMENT OF THE INTERIOR, ERASMO GONZALES, Area Manager, Houston Area Audit Office of the Minerals Management Service, and MINERALS MANAGEMENT SERVICE,

Respondents.

Petition For Writ Of Certiorari To The United States Court Of Appeals For The Fifth Circuit

AMICI CURIAE BRIEF OF MOUNTAIN STATES LEGAL FOUNDATION, INDEPENDENT PETROLEUM ASSOCIATION OF AMERICA, INDEPENDENT PETROLEUM ASSOCIATION OF MOUNTAIN STATES, AND ROCKY MOUNTAIN OIL & GAS ASSOCIATION IN SUPPORT OF PETITIONER

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RULE

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Mountain States Legal Foundation respectfully submits this *amici curiae* brief on behalf of itself, Independent Petroleum Association of America, Independent Petroleum Association of Mountain States, and Rocky Mountain Oil & Gas Association, in support of Petitioner, Enron Oil & Gas Company. Pursuant to Supreme Court Rule 37.2, this *amici curiae* brief is filed with written consent of all the parties.[1]

IDENTITY AND INTEREST OF *AMICI CURIAE*

Mountain States Legal Foundation ("MSLF") is a non-profit, membership, public interest, legal foundation organized under the laws of the State of Colorado. MSLF is dedicated to bringing before the courts those issues vital to the defense and preservation of individual liberty, the right to own and use property, limited government, and the free enterprise system. MSLF's members include businesses and individuals throughout the country who are involved in the exploration, production, and development of domestic oil and gas reserves.

Independent Petroleum Association of America ("IPAA"), is a national association which represents the 5,500 independent crude oil and natural gas explorers/producers in the United States. Independents: operate in all 33 states that have oil and natural gas production; drill about 85 percent of all wells in the United States; produce about 31 percent of domestic crude oil; and produce about 60 percent of the domestic natural gas.

[1] Copies of the consent letters were concurrently filed with the Clerk of Court.

Independent Petroleum Association of Mountain States ("IPAMS") is a non-profit, non-partisan, trade association representing the interests of approximately 700 independent oil and natural gas producers, royalty owners, industry consultants, and service/supply companies operating in the ten-state Rocky Mountain area: New Mexico, Wyoming, Colorado, Montana, North Dakota, Utah, Nebraska, South Dakota, Nevada, and Arizona. IPAMS seeks to promote exploration, production, and development of the oil and gas reserves in the Rocky Mountain region.

Rocky Mountain Oil and Gas Association ("RMOGA") is a non-profit, trade association whose members account for more than 90 percent of all exploration, production, transportation, refining, and marketing operations occurring in the oil and gas industry within the states of: Utah, Wyoming, Colorado, Idaho, North Dakota, South Dakota, Nebraska, and Montana.

A large number of *amici*'s members are lessees under federal oil and gas leases. *Amici*'s members produced natural gas from their federal oil and gas leases which they sold to various purchasers under long-term gas purchase contracts. These contracts provided that the purchase price to be paid for gas delivered was to be the maximum lawful price permitted by law. In addition, many of these contracts provided that the purchaser would reimburse the producer for *ad valorem* and severance taxes assessed against the working interest share by states and local governments.

Although most of these contracts are not in existence today, *amici* still have a direct and substantial interest in

the issues presented by this case because the U.S. Department of the Interior ("DOI") takes the position that statutes of limitations do not apply to the collection of royalties.[2] Thus, *amici*'s members potentially face audits and assessment of additional royalties based upon the Fifth Circuit's decision.

In addition, although most of the lands which will be directly affected by the decision in this case are located in the Rocky Mountain region, the decision may affect all public domain lands. Thus, *amici* believe that the public policy issues presented in this case have national significance. *Amici* assert that the DOI has erroneously interpreted the applicable federal statutes. Moreover, if upheld, the DOI's interpretations, as adopted by the Fifth Circuit, would abrogate congressional intent underlying these statutes and the public interests served thereby.

OPINIONS BELOW, JURISDICTION, AND STATEMENT OF THE CASE.

Amici hereby adopt Petitioner's description of the opinions below, statement of jurisdiction, and statement of the case.

[2] *See BHP Petroleum (Americas), Inc.*, 124 IBLA 185, 189 (1992); *Phillips Petroleum Co. v. Lujan*, No. 89-C-914-B, slip op. (N.D. Okla. October 24, 1991), *appeal docketed*, No. 92-5136 (10th Cir. July 14, 1992).

SUMMARY OF ARGUMENT

This Court should grant *certiorari* in this case for a number of reasons. First, the Fifth Circuit misinterpreted previous decisions by this Court, and thus failed to apply the correct standard of review. Second, the Fifth Circuit's decision frustrates congressional intent behind the NGPA because producers cannot receive the applicable maximum lawful price not reduced by severance taxes. Finally, the Fifth Circuit's decision creates an irreconcilable conflict between the provisions of the MLLA and the NGPA.

ARGUMENT

I. THE FIFTH CIRCUIT FAILED TO APPLY THE CORRECT STANDARD OF REVIEW TO THE DOI'S INTERPRETATION OF THE MLLA.

Pursuant to the Mineral Lands Leasing Act ("MLLA"), as amended, 30 U.S.C. § 181 *et seq.*, the DOI leases public domain lands for the exploration and production of oil and gas. The MLLA requires that federal leases contain a royalty provision which obligates the lessee to return to the federal government a royalty of not less than "12-1/2 percent in amount or *value of production* removed or sold from the lease." 30 U.S.C. § 226 (emphasis added). Thus, in passing 30 U.S.C. § 226, Congress intended federal lessees to return to the federal government a royalty – either in cash or in kind – based upon a specific percentage of the oil and gas produced from the lease. Therefore, when the federal government elects to take its royalty in cash, as it did in this case, the

federal government's royalty share of production is valued, and that amount is remitted to the federal government.

However, the DOI interprets 30 U.S.C. § 226 as meaning that the federal lessee must pay to the federal government a royalty based upon 12-1/2 percent of the value of the total production, *i.e.*, 12-1/2 percent of value of the entire gas stream. In the instant case, the Fifth Circuit indicated that it was compelled to defer to the DOI's interpretation of 30 U.S.C. § 226 because of the Fifth Circuit's reading of this Court's decision in *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984). Specifically, the Fifth Circuit concluded that the following standard of review was applicable: "where the determination at issue involves a statute's interpretation, an agency's interpretation of a statute it administers should be upheld if it is based on a 'permissible' construction of the statute." Petitioner's Appendix ("Pet. App.") A at 5a (citing *Chevron*, 467 U.S. at 834).

By applying this standard of review, the Fifth Circuit concluded that the DOI's interpretation of 30 U.S.C. § 226 was a "permissible" interpretation. Pet. App. A at 6a. Thus, the Fifth Circuit upheld the IBLA's decision that, for royalty calculation purposes, "value of production" was equal to the price received for the sale of all the gas plus the amount of severance taxes reimbursed by the purchaser.

However, in *Chevron*, this Court unmistakably ruled that an agency's construction of a statute is accorded no deference when the statute is unambiguous. *Id.* 467 U.S. at 843 n. 9. Indeed, "[t]he judiciary is the final authority

on issues of statutory construction and must reject administrative constructions which are contrary to clear congressional intent." *Immigration and Naturalization Service v. Cardoza-Fonseca*, 480 U.S. 421, 447-448 (1987) (quoting *Chevron*, 467 U.S. at 843 n. 9). By contrast, only when the "statute is silent or ambiguous with respect to the specific issue" may a court to defer to an agency's construction which is based upon a "permissible" construction of the statute. *Chevron*, 467 U.S. at 843.

The language of 30 U.S.C. § 226 is unambiguous. The statute obligates the lessee to return to the federal government a royalty equal to the value of the federal government's royalty share of production. 30 U.S.C. § 226. Because 30 U.S.C. § 226 is unambiguous, under *Chevron*, the Fifth Circuit should have interpreted 30 U.S.C. § 226, and should not have deferred to the DOI's interpretation. Thus, because the Fifth Circuit misinterpreted this Court's ruling in *Chevron*, and therefore failed to apply the correct standard of review, this Court should grant *certiorari* to review the Fifth Circuit's decision.

II. THE FIFTH CIRCUIT'S DECISION FRUSTRATES CONGRESSIONAL INTENT IN PASSING THE NGPA.

In 1938, Congress passed the Natural Gas Act ("NGA"), 15 U.S.C. §§ 717-717w. Pub.L. No. 75-688. The NGA was Congress' first attempt to regulate the natural gas industry. Under the NGA, the federal government could only impose price controls on sales of gas in interstate commerce. Consequently, prices for gas sold in the interstate market were kept relatively low, whereas,

prices for gas sold in the intrastate market rose as the demand for gas increased. *Mobil Oil Exploration and Producing Southeast, Inc. v. FERC*, ___ U.S. ___, 111 S.Ct. 615, 619-620, 112 L.Ed.2d 636 (1991). As a result, numerous gas shortages were experienced because of the curtailment of the delivery of gas in the low priced interstate market. *Id.*

By passing the National Gas Policy Act of 1978 ("NGPA"), 15 U.S.C. § 3301 *et seq.*, Congress sought to "alleviate the adverse economic effects of the disparate treatment of intrastate and interstate natural gas sales." *Maryland v. Louisiana*, 451 U.S. 725, 747 n. 22 (1981). In addition, Congress intended to prevent the gas shortages caused by the NGA and to encourage the development of new gas reserves. *Mobil*, 111 S.Ct. at 620. Congress attempted to achieve these goals in two ways. First, the NGPA subjected all sales of gas, in both the interstate and intrastate markets, to federal price controls. Second, the NGPA created an incentive-based price structure.

One example of the NGPA's incentive-based price structure is its price ceilings. The NGPA sets the maximum lawful price which producers can be paid for gas depending on when and how the gas is produced. *Mobil*, 111 S.Ct. at 620. Through use of price ceilings, Congress attempted to accommodate consumers by keeping old gas prices low while, at the same time, encouraging the development of new reserves through higher price ceilings on new and hard-to-produce gas. *Id.*

The NGPA's incentive-based price structure is also evidenced by its provisions which allow producers to be

reimbursed for certain post-production costs. For example, Section 110 of the NGPA provides, in pertinent part:

> (a) Except as provided in subsection (b) a price for the first sale of natural gas shall not be considered to exceed the maximum lawful price applicable to the first sale of such natural gas under this subtitle if such first sale price exceeds the maximum lawful price to the extent necessary to recover –
>
> > (1) State severance taxes attributable to the production of such natural gas and borne by the seller, but only to the extent the amount of such taxes does not exceed the limitation of subsection (b) . . . .

15 U.S.C. § 3320.

Thus, Section 110 of the NGPA ensures that producers receive the applicable maximum lawful price not reduced by severance taxes. Section 110 of the NGPA achieves this result by excluding severance tax reimbursements from the maximum lawful price of the gas. However, the amount of these severance tax reimbursements are limited to the extent necessary to recover the severance taxes actually "borne by the seller." 15 U.S.C. § 3320(a)(1).

Congress realized that if producers had to bear the expense of severance taxes while being limited by the NGPA's ceiling prices, producers would abandon many marginal wells, or worse, not develop new reserves. Accordingly, Congress structured the NGPA in such a way as to ensure that the price ceiling portion of the NGPA's incentive-based price structure was not affected by the payment of severance taxes. *See* 15 U.S.C.

§ 3320(a)(1). Concurrently, Congress also protected the interests of consumers by only passing on to consumers those severance taxes that were actually paid by the producer. *Id.* Thus, in Section 110 of the NGPA, Congress devised a way to balance the need to develop new reserves with the interests of consumers.

In the instant case, the Fifth Circuit rejected arguments regarding the significance of the NGPA and blindly relied upon its earlier decision in *Mesa Operating Ltd. Partnership v. U.S. Dep't of Interior*, 931 F.2d 318 (5th Cir. 1991), *cert. denied*, ___ U.S. ___, 112 S.Ct. 934, 117 L.Ed.2d 106 (1992). Pet. App. A at 9a. In *Mesa*, the plaintiff had received reimbursement of certain production-related costs from its gas purchasers with respect to offshore oil and gas leases issued pursuant to the Outer Continental Shelf Lands Act of 1953, 43 U.S.C. §§ 1331-1356. The plaintiff argued, *inter alia*, that it was not required to pay the federal government a royalty based upon reimbursement of such costs because to do so would create a conflict with the NGPA.

Section 110 of the NGPA allows a producer to receive reimbursement of production-related costs in addition to the maximum lawful price, just as it allows a producer to receive severance tax reimbursements in addition to the maximum lawful price. 15 U.S.C. § 3320(a)(2). However, in *Mesa*, the Fifth Circuit found that inclusion of reimbursements of production-related costs under Section 110 of the NGPA for royalty calculation purposes did not conflict with the NGPA. *Mesa*, 931 F.2d at 325-326.

Unfortunately, in the instant case, the Fifth Circuit failed to recognized the difference between production-

related costs and the payment of severance taxes. Section 110 of the NGPA allows for reimbursements of certain severance taxes and production-related costs if they are, in fact, actually paid. 15 U.S.C. § 3320. In *Mesa*, the production-related costs were actually paid with respect to the entire gas stream, including the federal government's royalty share of production. Thus, it was appropriate for the Fifth Circuit to include reimbursements of production-related costs for royalty calculation purposes.

By contrast, in the instant case, severance taxes were not paid on the federal government's royalty share of production, and thus Enron did not receive severance tax reimbursements with respect to the federal government's royalty share of production. Therefore, the Fifth Circuit's reliance on *Mesa* was misplaced.

In short, the Fifth Circuit failed to realize that if a producer is required to pay the federal government a portion of its severance tax reimbursement as royalty, in addition to paying the entire amount of severance taxes imposed, the producer is not receiving the benefit intended by Congress under Section 110 of the NGPA. Indeed, under the Fifth Circuit's decision, the producer is being required to accept the limitations imposed by federal price controls on the natural gas it produces, without receiving the corresponding incentive to produce associated with receiving reimbursement of the entire amount of severance taxes. Consequently, the producer must pay more in royalties, and thus will not receive the applicable maximum lawful price not reduced by severance taxes as mandated by Section 110 of the NGPA. Therefore, the intent of Congress, as evidenced by Section 110 of the NGPA, that producers receive the applicable maximum

lawful price not reduced by severance taxes has been frustrated by the Fifth Circuit's decision.[3]

III. THE FIFTH CIRCUIT'S DECISION CREATES AN IRRECONCILABLE CONFLICT BETWEEN THE PROVISIONS OF THE MLLA AND THE NGPA WHICH MUST BE ADDRESSED BY THIS COURT.

Notwithstanding the fact that a substantial portion of the nation's natural gas production is produced from public domain lands, and from oil and gas leases issued pursuant to the MLLA, the relationship between the MLLA and the NGPA has never been addressed by this Court. However, this is an issue of national importance as the nation's energy policy continues to develop.

1. The MLLA, As Construed By The Fifth Circuit, Is In Direct Conflict With The Provisions Of The NGPA.

Under the MLLA, royalty is based upon the "value" of the federal government's royalty share of production. *See* 30 U.S.C. § 226. On the other hand, under Section 110 of the NGPA, severance tax reimbursements may not be received in addition to the maximum lawful price otherwise specified in the NGPA except to the extent the

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[3] Congressional intent is further frustrated because under the Fifth Circuit's decision the price received by producers after severance tax reimbursements is different depending upon the tax rate in the state where the gas is produced, even though the whole purpose behind the NGPA was to create uniform prices.

severance tax is actually paid by the seller. 15 U.S.C. § 3320.

In the instant case, Enron sold the federal government's royalty share of production for the maximum lawful price permitted by the NGPA. Pursuant to the MLLA, Enron paid the federal government a royalty based upon the "value" of the government's royalty share of production, *i.e.* the maximum lawful price which Enron received for the federal government's royalty share of production. However, because Enron did not pay any severance taxes, nor receive any severance tax reimbursements, with respect to the federal government's royalty share of production, the maximum lawful price for the federal government's royalty share of production under Section 110 of the NGPA did not, and could not, include severance tax reimbursements.

Nevertheless, the DOI's construction of the MLLA, adopted by the Fifth Circuit, allows the federal government to be paid a royalty on a "value" which includes severance tax reimbursements even when no severance taxes were paid on the federal government's royalty share of production.[4] However, the term "value" has a long-standing meaning under both federal and state law. In fact, under the Fifth Circuit's decision, "value" means the "gross proceeds" that a purchaser will pay a producer for the delivery of natural gas. Pet. App. A at 6a. Yet, no willing purchaser could, or would, pay a severance tax reimbursement as to the federal government's royalty

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[4] Thus, in effect, the DOI has established a "value" for the federal government's royalty share of production which exceeds the maximum lawful price specified by the NGPA.

share of production not only because it would be illogical to do so, but also because to do so would clearly violate the maximum lawful price provisions of the NGPA. Therefore, the "value" of the government's royalty share of production cannot include severance tax reimbursements.

The foregoing notwithstanding, the Fifth Circuit ruled that whether or not the "value" established for the government's share of production exceeds the maximum lawful price specified by the NGPA is of no consequence. Specifically, the Fifth Circuit stated:

> The DOI-lessor simply obtains a flat percentage of all 'gross proceeds' whether they be within the ceiling price or exceed it under [15 U.S.C. § 3320(a)], obtaining more royalty where the lessee obtains a greater price, including cost reimbursements, from the pipeline purchaser.

Pet. App. A at 8a (quoting *Mesa*, 931 F.2d at 325). Thus, because the MLLA, as construed by the Fifth Circuit, is in direct conflict with the NGPA, this Court should grant *certiorari* to review the decision of the Fifth Circuit to determine the appropriate relationship between royalty payable to the federal government under the MLLA, and the provisions of the NGPA.

2. The Provisions Of The MLLA Should Be Construed Consistently With The Provisions Of The NGPA.

It has long been established that it is the duty of the courts to construe two applicable statutes in such a way as to be consistent and not in contradiction with one another. *Watt v. Alaska*, 451 U.S. 259, 267 (1981),

Ruckelshaus v. Monsanto Co., 467 U.S. 986, 1018-1019 (1989). It is *amici*'s position that the royalty provisions of the MLLA should be construed in a manner that is consistent with the statutory language contained in the NGPA.

For example, the term "value" upon which royalty is payable to the federal government under the terms of the MLLA should be construed as meaning that for which natural gas produced from the lease premises may be legally sold under the provisions of the NGPA. Such a construction would mean that the federal government would receive a royalty equal to the price actually received for the federal government's royalty share of production. Only in this way can both the statutory provisions of the MLLA and the NGPA be given full effect.

CONCLUSION

For the foregoing reasons, *amici* respectfully request that this Court grant *certiorari* to review the Fifth Circuit's decision.

DATED: May 27, 1993.

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